FILE COPY

Supreme Court, U. S.
FILED
SEP 27 1973
MICHAEL RODAK, JR., CLERK

No. 72-1401

In the
Supreme Court of the United States
OCTOBER TERM, 1972

BALAX, INC. and JOHN M. VAN VLEET,
Petitioners,

vs.

THE BENDIX CORPORATION and
SELLEW CORPORATION,
Respondents.

PETITIONERS' REPLY TO RESPONDENT'S BRIEF OPPOSING THE PETITION FOR CERTIORARI

EDWARD A. HAIGHT
JOHN W. HOFELDT
55 East Monroe Street
Chicago, Illinois 60603

THOMAS O. KLOEHN
780 North Water Street
Milwaukee, Wisconsin 53202
Counsel for Petitioners

© The Scheffer Press, Inc.—(312) 263-6850

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1972

No. 72-1401

BALAX, INC. and JOHN M. VAN VLEET,
Petitioners,

vs.

THE BENDIX CORPORATION and
SELLEW CORPORATION,
Respondents.

PETITIONERS' REPLY TO RESPONDENT'S BRIEF OPPOSING THE PETITION FOR CERTIORARI

Petitioners submit this Reply Brief directed to the new issues raised by Respondents' Brief in Opposition to Petitioners' Petition for a Writ of Certiorari.

ARGUMENT

A. Petitioners' Antitrust Counterclaim is Not Based on Lear v. Adkins.

Respondents succeeded in having the decision of the District Court sustaining the antitrust counterclaim reversed below by arguing as is done here (Resp. Br., p. 7):

> "Balax's antitrust counterclaim is founded upon the *Lear* decision of this Court."
> * * *
> "This case is a direct outgrowth of the Supreme Court decision in Lear, Inc. v. Adkins, 395 US 653 (1969). ***"

From these and similar inaccurate statements elsewhere in the Respondents' brief, Respondents argue that this Court should not concern itself with this case. The argument is (Resp. Br. pp. 2-3) that since *Lear* "licensee estoppel terms have been automatically void and unenforceable" and, therefore, there are "supposed antitrust consequences for only those few license agreements entered into prior to 1969***."

However, the antitrust counterclaim before the Court could not be founded upon or an outgrowth of *Lear*. The District Court, which sustained the counterclaim, rejected *Lear* as the basis for the counterclaim. (A. 163-4). And the counterclaim was pleaded, tried, appealed and briefed on the first appeal before the decision in *Lear* was even handed down by this Court.

Rather, this antitrust claim arises from Respondents' use of rights to contract under State law and to sue for patent infringement under Federal law:

1) to combine with competitors and regiment the industry, specifically those competitors who had the motive, resources and, in one instance at least, the evidence to invalidate Respondent's patents; and

2) to attempt to limit or eliminate Petitioner Balax as a competitor to the members of the combination by a restrictive license, and when that effort failed, by the ultimate weapon of a patent infringement suit brought by Respondent, Besley.

By the time of the infringement suit, the combination included Respondent Besley and ten of its erstwhile competitors who had agreed to operate under the umbrella of Respondent's patents and to maintain the facade of validity of those patents. Five were licensed to manufacture swaging taps under Respondent's patents. The other five had entered into written agreements with Respondent to purchase all their requirements of swaging taps from Respondent and its manufacturing licensees. All had agreed that the validity of Respondent's patents was never to be contested, even though at least one of them possessed invalidating evidence and the opinion of its patent counsel that such patents were invalid.

By the time of hearing on reconsideration of the antitrust claim, only two competing non-licensed manufacturers of swaging taps remained outside the group—Petitioner and another whose sales were "not significant in amount." (App. B, pp. 41-42).

Lear has no application to facts such as these. It did not deal with written covenants perpetually prohibiting challenge to patent validity, but with estoppels to such challenge implied by law from the licensor-licensee relationship. Further, *Lear* was not concerned with restrictive covenants which were included, not only in patent licenses,

but also in requirements purchase agreements and jobber sales contracts involving no grant of patent rights. And *Lear* did not involve a group of competitors subscribing to such a restrictive covenant, thereby manifesting the intent of each and of the group to refrain from attacking the validity of patents under which they could operate to their mutual advantage and to the exclusion of competitors outside the group.

Long prior to *Lear*, this Court held that contracts prohibiting challenge to patent validity are outside the scope of the grant of the patent statutes and have a basis only in contract law. In *Pope Manufacturing Co.* v. *Gormully*, 144 U.S. 224, this Court held that a contract containing such restrictive covenants was subject to the reach of the laws prohibiting agreements which are in restraint of trade or otherwise void as against public policy. Petitioners' claim is that agreements here are subject to the reach of the antitrust laws quite apart from the decision in *Lear*. Those agreements were void under the law prior to *Lear* and *Lear* certainly does not retroactively validate them as Respondents' tortuous reasoning attempts to establish.

Respondents argue that in *Pope* the covenant prevented challenge only to unlicensed patents, and labels this a "crucial distinction" from the case at bar (Resp. Br., p. 9). To the contrary, in this respect the case at bar is on all fours with *Pope*. Here there was no grant of patent rights in the agreements with requirements purchasers and a mere jobber, which agreements nevertheless included the restrictive covenants. Further, the basis of the holding in *Pope* was that the limited monopoly of the patent grant did not include the right to immunize patents from validity challenge by restrictive agreements.

Respondents attempt to justify the agreement precluding challenge to Besley's patents—euphemistically called "estoppel clauses"—on a number of grounds. It is argued that "there is no indication that these licensee estoppel clauses had any actual impact on any licensee" (Resp. Br., p. 5). At best, the observation is irrelevant. The impact on the public of patents maintained valid and assertable by agreement of a dominant group of competitors not to attack their validity is what matters, not the impact on the agreeing competitors. And, if impact on a licensee is an issue, consider the competitor who honored the agreement despite the invalidating evidence in its files and the opinion of its patent counsel that the licensed patents were invalid.

Respondents also argue (Resp. Br., p. 5):

> "Prior to entering into a license agreement, each licensee had been free to contest patent validity. There is no evidence that, after entering into a license agreement, any licensee ever attempted to contest Besley's patents."

This establishes the evil of which Petitioners complain rather than being a justification. Those competitors previously free and best able to contest the validity of Besley's patents agreed with Respondent to remain silent and accepted membership in "our group" which stood to benefit from the limited competition insured by the patents—for so long as the statutory presumption of validity could be maintained against outsiders such as Petitioner.

It is also urged that the agreements did not prevent Petitioner from selling to manufacturers and distributors of taps (Resp. Br., p. 6). This is so, Respondents argue, because Petitioner obtained patents on an improved type

of swaging tap, and "What better proof can there be that Belsey's patents did not cover all swaging taps?" (Resp. Br., p. 6).

This rhetoric could be viewed as naive if the taps charged to infringe Besley's patents had not been the improved taps of Petitioner's patents. Further, "better proof" would have been a holding that such taps did not infringe Besley's patents. However, the District Court held and the Court of Appeals agreed that the improved taps would infringe if the patents were valid. And the purpose for the restrictive covenants with the selected competitors was to avoid having the validity of those patents placed in issue.

Respondents also profess to have freely licensed others" (Resp. Br., p. 3). If by "others" is meant the selected competitors, the statement has basis. But it has no application to those outside the select group such as Petitioner. Respondent's right to license was used to attempt to exclude Petitioner's competition.

Not that Petitioner Balax was not offered a license. That license required that Balax not offer the same tap as was being offered by Respondent and its licensees, and that Balax agree to charge higher prices for its tap than the price charged by Respondent and its licensees for their tap.

Respondent so much as told its licensees, whose permission was required for the offer, that the intent was to eliminate competition from Balax. The license offered, Respondent explained, "was a unique license" which Respondent "did not regard . . . as a device for putting new competition into business on" the taps of Respondent and its licensees (A. 310). Further, the select group was told that Petitioner, "a small shop near Milwaukee", was not

among the "competitors we know and respect", to be included in "our group" (App. II, pp. 502-4).

And when this competition limiting license offer was rejected, Respondent was ready. Then Respondent's view was that the Balax tap "poses more of a competitive threat in the market" and for this reason Petitioner Balax was sued for patent infringement (App. B., p. 45).

Especially, in view of the confessed intent to limit, if not outright eliminate, Petitioner as a competitor by the license route, there is little substance to the profession that the license offer to Petitioner was made in "good faith" (Resp. Br., p. 4).

B. The Error of the Court of Appeals On Market Dominance is Unanswered.

The second of the Reasons for Granting The Writ (Pat., pp. 20-23) is the basis on which the Court of Appeals concluded there was insufficient market dominance by Respondent to establish a Section 2 violation. In arriving at that conclusion, the Court of Appeals improperly compared current net sales with an estimated future potential gross market which is three times larger than the actual market.

Evidently unable to support such holding, Respondent directs its argument to the scope of the relevant *product* market. But even in that argument Respondent is on shaky ground. The District Court, as noted in the Petition (p. 22), held the relevant product market to be swaging taps (App. B., p. 47; App. A., p. 21). Although critical of the trial court's findings on that issue, the Court of Appeals did not reverse on that basis.

Respondents argue (Br., p. 13):

> "The Census Bureau recognized only one product line in this area, encompassing both swaging and cutting

> taps. According to records maintained by the Census Bureau (PX 179, App. Ex. p. 204) and the Metal Cutting Tool Institute (PX 178, App. Ex. p. 201M), swaging and cutting taps account for about $60,000,000 in annual sales: In the Seventh Circuit, Balax agreed that the overall tap market was $60,000,000. (Balax Seventh Circuit Brief, pp. 9-10, 43)."

Respondents tried, but failed, to adduce evidence to support the first two sentences quoted above. Both the Census Report and the reports of the MCTI made of record expressly relate to "cutting tools", and the witness who identified these documents and testified to them on behalf of Respondent, Mr. Heldenbrand, testified that a swaging tap is *not* a "cutting tool". (A-574).

The Census Report maintains a clear distinction between "*** 'cutting tools' or the actual cutting elements that directly remove material in the form of chips, ***" and "some closely related tools" (Ex. Vol. I, p. 248). As to the latter, the Census Report states: "All of these items are separately identified and individually reported in the detailed shipment (table 5)". (Ibid). Nowhere in the Census Report or in the MCTI report is there any mention of swaging taps. Mr. Heldenbrand testified that he had no knowledge or information regarding the "records maintained by the Census Bureau" or the MCTI, other than the practices followed by Respondent in reporting to those two agencies. (A-574). Mr. Heldenbrand testified that Respondent reports swaging taps along with cutting taps, and to substantiate his testimony produced the 1967 Census Report by Respondent's Threadwell facility, which does not make swaging taps (A-576), but which purchased for resale under a requirements contract with the Besly-Welles facility of Respondent. (Ex. V, Vol. I, p. 119). However,

Mr. Heldenbrand admitted that Threadwell reported *no* swaging taps (A-576), even though such a report would be required (Ex. A. Vol. I, p. 227) for swaging taps purchased for resale.

Moreover, Petitioners at no time, in the Seventh Circuit or in the District Court, agreed as Respondents assert, that the "overall tap market was $60,000,000." The truth is that Petitioners stated that annual domestic "*cutting* tap" sales only are approximately $60,000,000.

Respondents further assert (Br., p. 15): "Thus, Balax contended that the relevant market was $6,000,000", and charges that in the Petition, "Balax has totally reversed its field." Neither of those statements is accurate. Petitioners have always specified that the $6,000,000 figure represented the estimated potential future market for swaging taps if and when the swaging tap market is fully exploited. The Court of Appeals was careful to so describe that dollar amount. (App. A. p. 22). Petitioners have consistently contended throughout this entire litigation that wherever swaging taps have replaced cutting taps, cutting taps have been unable to compete with swaging taps. When the testimony referred to by Respondents on page 13 of their Brief is read in context, it establishes that cutting taps present no competition for sale to swaging tap users.

C. Respondents Raise New Issues Attempting To Avoid Liability.

The third of the "REASONS FOR GRANTING THE WRIT" (Pet., pp. 23-30), is the error of the Court of Appeals holding that Petitioners failed to adduce sufficient evidence of injury to sustain a cause of action under Section 4 of the Clayton Act. Respondents are silent on that issue, apparently agreeing that the Court of Appeals disobeyed this Court's instructions in *Zenith Radio Corp* v.

Hazeltine Research, Inc., et al., 395 U.S. 100 (1969). Instead, Respondents raise two new issues in avoidance of a liability, namely: (1) was initiation of this action by Respondent Besley part of a combination in restraint of trade under Section 1 of the Sherman Act, and (2) did any other antitrust violations by Respondent cause the injury proved?

The first issue is implicitly answered above in discussion of the *Lear* issue, and in related portions of the Petition. Response to the second issue is stated here.

Respondents rely (Br., p. 18) upon the 1968 testimony of Petitioner Balax's sales manager to the effect that distributors' preference for handling both swaging taps and cutting taps limited Petitioner's ability to obtain distributors for its only product, swaging taps. However, the important testimony extracted by Respondent from its own witness in 1970 is neglected.

Petitioner Balax learned for the first time in the November, 1970 hearing on reconsideration, from Respondent's only witness on these antitrust issues, that Respondent Besley and the other major competitors will deal only with exclusive distributors who agree to handle only one manufacturer's product line. (A-567). Thus, Respondents revealed that the resistance Petitioner had interpreted as merely distributor preference was in reality the result of manufacturers' coercion, extending to the entire product line—those numerous other products in the tap catalogues, such as dies, screw plates, tap wrenches, screw extractors, burring reamers, taper reamers, pipe reamers, center taps, tap drivers, chucks, holders, sleeves, collapsible taps, adjustable taps and gages (Ex. A Vol. II, pp. 342, 646) and, in Threadwell's Census Return, broaches, twist drills, counterbores, milling cutters, slitting saws and other cutting tools and accessories (Ex. A., Vol. I, pp. 222-4).

The fact of this prevailing practice in the industry made it vital to Petitioner's business that it have competitive access to the larger cutting tool manufacturers who did not produce swaging taps. Such access was shut off by Besley's requirements agreements containing perpetual covenants never to challenge patents and the combination to exclude new competition.

Petitioner Balax was also unable to obtain necessary fluted blanks from which to make cutting taps at a price that would allow Balax to compete. Contrary to Respondents' assertion (Br., p. 18), that supply problem was indeed connected with Respondent Besley, for it was one of the three manufacturers from whom Petitioner tried to get fluted blanks. In 1961 the quoted prices to Petitioner were only 10% less than 1966 prices for completed taps in some quatities and were actually higher than 1966 prices for completed taps in other quantities. (Compare Ex. A. Vol. I, p. 155 with Ex. A. Vol. II, p. 422 less distributor's discount Ibid. p. 491). The only sources of fluted tap blanks are major cutting tap manufacturers having the sales and resources to acquire and support automatic flute grinding machines (A-656); consequently, Respondent Besley and its selected licensees held the key to entry of competition into the cutting tap market.

Respondents state (Br., p. 19) that "There is no evidence at all in the record that Besley [Bendix] had any influence over the price of swaging taps." The record establishes that Besley and its licensees sold swaging taps at identical consumer list prices (A-536, 568). Those prices are published (A-568). However, manufacturers, including Besley, sell swaging tap to their exclusive distributors at the published list price *less* a distributor's discount (A-595). The discount is restricted information (A-596). Hence the public and, presumably, competitors would

not know the price charged by Besley and competing manufacturers to their respective distributors.

Petitioner Balax did not know the confidential distributor discounts given by Respondent Besley (A-673). However, Respondent's licensees had that information since Respondent sent its confidential discount sheets to its licensees (A-597-598, 600). As might be expected, the confidential prices of the three competitors, Respondent, Threadwell and United Greenfield, whose price lists and discount sheets are of record, were identical. (Ex. A. II, pp. 315-495). And these prices, which placed a floor under negotiated consumer prices, could not have coincided by normal market operation, but required collusion. Add to that the attempts of Respondent Besley to induce Detroit Tap & Tool (Ex. A. Vol. II, p. 273) and Petitioner (Ex. A. Vol. I, p. 181) to enter into price fixing agreements, and the presence of evidence establishing Respondent's improper influence on pricing cannot be denied.

Respondents' statement that "Balax has never challenged the ruling on the first appeal that Besley lawfully obtained and enforced its patents" (Br. pp. 16-17) is grossly misleading. In the first place, there was no ruling that Respondent "lawfully obtained" its patents. Of the three patents in suit, one was stipulated to be invalid because of the patentee's own prior public use and another was held invalid for the same reason: this notwithstanding the oaths to both applications that there was no prior public use.

The third patent was ruled invalid because the claimed invention was completely disclosed in a 1938 German patent. Respondents allude (Br., p. 17) to the holding by the Court of Appeals invalidating its third patent "upon an obscure German petty patent." As early as May 26, 1959, long before this action, one of Respondent's contract

purchasers, informed Respondent Besley, that the same "obscure German petty patent" invalidated the third patent. And Respondent knew of that fact before it acquired Besley. The fact that one of the three patents temporarily survived court action hardly warrants accolades of good behavior for Respondents.

At least four times in its brief Respondents mention "20,000 distributors" supposedly available to purchase swaging taps from Petitioner Balax. The figure "20,000" occurs only once in the record and is alluded to only once again in the record by Respondents' counsel. Both references are in the November, 1970 testimony of Respondent's only antitrust witness who testified that that many industrial distributors were potential customers for Respondent's cutting and swaging taps.

But the number of potential customers that were available to the huge multi-national conglomerate Respondent is neither relevant to this case nor an indication of how many customers were available to the much smaller and less extensive Petitioner Balax. Cross examination of Balax's sales manager disclosed that 35 distributors had been acquired by Petitioner—after a decade of effort.

Petitioners submit that Respondents have failed to diminish in any respect the compelling reasons for the granting of the Petition For the Writ of Certiorari.

Respectfully submitted,

Edward A. Haight
John W. Hofeldt
Thomas O. Kloehn
Counsel for Petitioners.